

The U.S.-Peru Trade Promotion Agreement

**Report of the
Trade and Environment Policy Advisory Committee (TEPAC)**

February 1, 2006

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Advisory Committee Report to the President, the Congress and the United States Trade Representative on The U.S.-Peru Trade Promotion Agreement

I. Purpose of the Committee Report

Section 2104(e) of the Trade Act of 2002 requires that advisory committees provide the President, the U.S. Trade Representative (USTR), and Congress with reports required under Section 135(e)(1) of the Trade Act of 1974, as amended, not later than 30 days after the President notifies Congress of his intent to enter into an agreement.

Under Section 135(e) of the Trade Act of 1974, as amended, the report must include an advisory opinion as to whether and to what extent the Agreement promotes the economic interests of the United States and achieves the applicable overall and principal negotiating objectives set forth in the Trade Act of 2002. The report must also include an advisory opinion as to whether the Agreement provides for equity and reciprocity within the sectoral or functional area of the particular committee.

Pursuant to these requirements, the Trade and Environment Policy Advisory Committee (“TEPAC” or “the Committee”) hereby submits the following report, which the Committee recommends be included in Congress’s record of deliberation on the Agreement, so that, among other things, it might provide guidance to deliberative bodies which will later examine the Agreement’s specific provisions on which we comment.

II. Preliminary Statement

In every report TEPAC has produced since passage of the Trade Act of 2002, it has unanimously stressed that 30 days is an insufficient period of time for it to thoroughly review, analyze, and provide its opinion on free trade agreements. USTR and/or the White House have, on occasion, provided some relief to this very tight timeline by providing TEPAC with a final version of the negotiated text prior to providing official notification to Congress. No such previews have occurred recently. As a result, TEPAC has become increasingly frustrated concerning the limited time it has to perform a fairly complex task, particularly given the divergent viewpoints of its members.

The Committee’s frustration is heightened with this report, for which USTR provided notification late in the day on January 6 (many members of TEPAC did not receive the notice until Monday, January 9). That notification mandated that TEPAC (and the other advisory committees) provide USTR their final reports by February 1 – sixteen business days later (given the Martin Luther King, Jr. holiday). Further, an integral factor in TEPAC’s analysis – the U.S.-Peru Environmental Cooperation Agreement -- was not made available by the Department of State to TEPAC until January 17, 11 business days before the report deadline.

This is not an adequate period of time to perform this review. TEPAC unanimously asks, again, that either Congress extend the deadline provided in the 2002 Trade Act or that USTR consistently provide TEPAC with advance versions of future FTAs' final texts, so that TEPAC can provide thoughtful comments, as it has been mandated to do.

III. Executive Summary of the Committee's Report

A majority of the Committee's members support the conclusion that the Agreement provides adequate safeguards to ensure that Congress's environmental negotiating objectives will be met. However, this conclusion was not an easy one. As it has frequently noted, TEPAC does not believe that "one size fits all" with regard to Free Trade Agreements (FTAs). This Trade Promotion Agreement (TPA) has increased public participation provisions as compared to other Agreements. However, it falls short of providing the extensive public participation framework which appeared in the Central American Free Trade Agreement (CAFTA). TEPAC believes that the inclusion of such a framework would significantly increase the likelihood that the Agreement's environmental provisions will be fully and effectively implemented. TEPAC urges that USTR modify the agreement as soon as possible to include such a framework. This is particularly important given that this agreement will most likely serve as a template for the remainder of the Andean Free Trade signatories. As addressed below, there were minority views regarding this point.

A majority believes that the Agreement's investment protection and dispute resolution provisions are an improvement over those in the North American Free Trade Agreement (NAFTA). The Committee believes that these provisions reduce the possibility that there will be successful challenges to attempts to implement more stringent bona fide environmental controls while simultaneously protecting investment. However, as it has expressed in its four other recent reports, TEPAC is concerned about identifying protected interests with the phrase "a tangible or intangible property right or interest." There is a lack of clarity regarding the definition of this term and there is no comparable U.S. jurisprudential concept.

A majority of the Committee's members are pleased to see environmental issues integrated into the drafting of a free trade agreement. This majority continues to believe that trade agreements can create opportunities to enhance environmental protection. Trade opens markets, creates business and employment opportunities, and can increase economic growth. This can lead to increased wealth, which provides opportunities to enhance environmental protection, including the creation of a political will in favor of such protection. However, trade can create and amplify adverse externalities which require enhanced regulatory oversight.

A majority believes that the Agreement's dispute resolution provisions are an improvement over those in the North American Free Trade Agreement (NAFTA) and over many recent FTAs, with the notable exception of CAFTA.

As discussed above, a majority of TEPAC would like to see additional provisions included in the Agreement. As it has alluded to in previous reports, TEPAC believes that public participation helps ensure that an agreement's provisions operate as intended and greatly increases

opportunities to guarantee the effective enforcement of environmental laws and to enhance capacity building and sustainable development efforts. It is pleased to see that steps are being made to increase public participation in the region and urges USTR and Congress to monitor closely the implementation of these provisions.

A similar majority of the members believes the dispute resolution procedures will help ensure that the FTA meets Congress's environmental objectives, but thinks that these procedures are not as effective as they should be. The majority is especially concerned about the fact that the public submission process does not reflect a mandatory requirement that dispute resolution panels accept submissions from civil society.

The majority believes that the Agreement's monetary penalties of up to \$15 million per year for instances of non-compliance with rulings confirming violations of enforcement requirements is an adequate compromise position.

A majority of the Committee believes that the Agreement Between The Governments of Peru and The United States on Environmental Cooperation (Memorandum of Agreement) provides a reasonable basis for the fulfillment of Congress's objectives regarding capacity building and sustainable development. However, the Memorandum of Agreement would be improved by the inclusion of specific areas of cooperation. While areas of cooperation are included, they are at a general, conceptual level that affords very little guidance on the subjects which will receive the parties' focus. For example, there is no attempt to address the illegal mahogany trade despite evidence the trade is being conducted in violation of the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES). The majority believes that this issue should be specifically addressed. Moreover, the Memorandum of Agreement would be improved if it were an integral part of the Agreement rather than a side agreement and if it had an available dedicated funding source. Without a funding source, achievement of the goals of the Memorandum of Agreement is at best ephemeral.

The majority believes that the Agreement's tariff reductions fulfill Congress's mandate to seek market access, through the elimination of tariffs and nontariff barriers, for United States environmental technologies, goods, and services.

A majority believes that the TPA should include a statement on promoting sound corporate stewardship.

Nevertheless, several differing viewpoints exist among committee members. These include the beliefs that 1) the Agreement's intellectual property provisions are harmful to consumers; 2) the Agreement's investment provisions weaken traditional protections for U.S. investors; 3) there is no need for greater regulatory oversight of environmental issues as a result of increased trade; 4) more extensive environmental provisions that were included in other FTAs, such as those in CAFTA-DR, should not have been used as a template and included in the Peru Agreement; 5) a "sound corporate stewardship" statement is not needed in the Agreement; 6) the Memorandum of Understanding on environmental capacity building need not to be an integral part of the FTA; 7) the biological diversity provision fails to recognize that property rights and technological advances can lead to higher yields and greater resource efficiency; and 8) the Agreement's

investment provisions contain troublesome substantive rules and investor-state dispute settlement procedures and fail to provide an appellate procedure to curb errant arbitral panels.

IV. Brief Description of the Mandate of TEPAC

As described in its charter, TEPAC's mandate is to (1) provide the U.S. Trade Representative with policy advice on issues involving trade and the environment and (2) at the conclusion of negotiations for each trade agreement referred to in Section 102 of the Act, provide to the President, to Congress, and to the U.S. Trade Representative a report on such agreement which shall include an advisory opinion on whether and to what extent the Agreement promotes the interests of the United States.

V. Negotiating Objectives and Priorities Relevant to the Report

As is made clear from its mandate, this committee's primary focus is on issues involving trade and the environment. In the Trade Act of 2002, Congress elucidated the principal trade negotiating objectives related specifically to environmental matters:

(A) to ensure that a party to a trade agreement with the United States does not fail to effectively enforce its environmental. . . laws, through a sustained or recurring course of action or inaction, in a manner affecting trade between the United States and that party after entry into force of a trade agreement between those countries;

(B) to recognize that parties to a trade agreement retain the right to exercise discretion with respect to investigatory, prosecutorial, regulatory, and compliance matters and to make decisions regarding the allocation of resources to enforcement with respect to other. . . environmental matters determined to have higher priorities, and to recognize that a country is effectively enforcing its laws if a course of action or inaction reflects a reasonable exercise of such discretion, or results from a bona fide decision regarding the allocation of resources, and no retaliation may be authorized based on the exercise of these rights or the right to establish domestic. . . levels of environmental protection;

(C) to strengthen the capacity of United States trading partners to protect the environment through the promotion of sustainable development;

(D) to reduce or eliminate government practices or policies that unduly threaten sustainable development;

(E) to seek market access, through the elimination of tariffs and non-tariff barriers, for United States environmental technologies, goods, and services; and

(F) to ensure that. . . environmental, health, or safety policies and practices of the parties to trade agreements with the United States do not arbitrarily or unjustifiably discriminate against United States exports or serve as disguised barriers to trade.

Moreover, two environmental objectives appear in Congress's overall negotiating objectives:

(G) to ensure that trade and environmental policies are mutually supportive and to seek to protect and preserve the environment and enhance the international means of doing so, while optimizing the use of the world's resources; and

(H) to seek provisions in trade agreements under which parties to those agreements strive to ensure that they do not weaken or reduce the protections afforded in domestic environmental . . . laws as an encouragement for trade.

Finally, the Trade Act also provides for the promotion of certain environment-related priorities and associated reporting requirements, including:

(I) conducting environmental reviews of future trade and investment agreements consistent with Executive Order 13141 and its relevant guidelines and reporting to the Committees on the results of such reviews; and

(J) continuing to promote consideration of multilateral environmental agreements and consult with parties to such agreements regarding the consistency of any such agreement that includes trade measures with existing exceptions under Article XX of the GATT 1994.

In addition to these environmental objectives, which are core objectives relevant to TEPAC's mandate, there are other Congressional trade objectives which affect the achievement of these objectives. These other objectives, which have been the subject of frequent discussion and comment by the members of TEPAC, include those related to investment, transparency, dispute resolution, capacity building, technical barriers to trade, intellectual property, agriculture, and sanitary and phytosanitary measures.

VI. The Committee's Advisory Opinion on the Agreement

As expressed in its reports on other recent FTAs, a majority of the Committee continues to believe that trade agreements can create opportunities to enhance environmental protection. Trade opens markets, creates business and employment opportunities, and can increase economic growth. This can lead to increased wealth, which provides opportunities to enhance environmental protection, including the creation of a political will in favor of such protection. It is also noted that trade can create and amplify adverse externalities which require enhanced regulatory oversight. A majority of TEPAC notes with satisfaction that environmental issues continue to be addressed in the text of free trade agreements. Further, it is pleased to see that this agreement contains more extensive public participation provisions than other recent FTAs, with the notable exception of CAFTA. It believes, however, that these provisions should go further.

A. Strict Compliance With Congress's Mandated Objectives and The Need For Effective Implementation

TEPAC recognizes that the Agreement incorporates the ten environmental trade negotiation objectives outlined above. Six of the ten ("A" through "D," "H," and "J" above) are explicitly referenced, almost verbatim, in Chapter 18 of the Agreement, one more ("F") is generally referenced in the Agreement's environmental definition provision, another ("I") has been accomplished through the conduct of an environmental review for the TPA, the ninth ("H") would be achieved through the general implementation of the Chapter, and the remaining one ("E") is reflected in the Agreement's tariff reduction schedules.

As it has for other reports, in examining the Agreement for consistency with Congress's environmental trade objectives, TEPAC has looked beyond the issue of whether the Agreement simply recites those objectives to the question of whether those objectives will come to fruition. However, the question of whether those objectives will actually be achieved requires effective implementation. This in turn, requires not only adequate and efficient implementation measures, but also adequate funding and adequate enforcement measures. In the analysis of these factors, the Committee's unanimity breaks down. In examining these issues, some committee members believe that the provisions and mechanisms are adequate, while others believe that they are too weak or, conversely, too strong. As there was no unanimity in these analyses, they have not been presented as such. Instead, the opinion of the majority or minority is presented. Where a lengthy minority opinion was provided, that separate opinion is summarized and the full opinion attached hereto to give the reader a more detailed explanation.

B. Actual Achievement of the Mandate

1. Background

Historically, the most contentious trade agreement provisions relating to the environment have been those relating to investment protection and dispute resolution. The Committee members' analysis of the environmental implications of these provisions is based largely on their and others' experience with NAFTA, bilateral investment treaties, and the emerging jurisprudence thereunder. Congress, for example, gave specific instructions to U.S. trade negotiators as a result of its concern that NAFTA's investment protection and dispute resolution provisions might hinder a Party's attempts to implement more stringent (but bona fide) environmental controls. By "bona fide," we refer to environmental controls which are not adopted for the purpose of arbitrarily or unjustifiably discriminating against imports or foreign investors or are not simply disguised barriers to trade or foreign investment.

In recent years, TEPAC has also placed increasing importance on public participation. TEPAC believes that public participation is an integral aspect of the implementation and ongoing operation of the environmental provisions of FTAs. In addition to helping to ensure that the provisions operate as drafted, public participation greatly increases opportunities to guarantee the effective enforcement of environmental laws and enhances capacity building and sustainable development efforts.

2. General Conclusion

a. General

With this background, a majority of the Committee believes that the Agreement's dispute resolution provisions are an improvement over those in NAFTA. The Committee believes that these provisions reduce the possibility of successful challenges to attempts to implement more stringent bone fide environmental controls while simultaneously protecting investment. The Agreement gives appropriate attention to integrating the achievement of enhanced environmental protection into more traditional notions of bilateral investment and trade, although this attention must be further nurtured.

b. Investment

As with the other recent FTAs, one improvement is the fact that the definition of investment is more precise. Most significantly, the issue of "indirect expropriation" or what we in the United States call regulatory takings has been clarified by changing the terminology from "tantamount" to "equivalent" and elaborating on this term in a letter declared to be an integral part of the agreement. The concern that regulatory actions will provoke claims by affected investors of indirect expropriation has been lessened by the declaration that "[e]xcept in rare circumstances, nondiscriminatory regulatory actions . . . to protect legitimate public welfare objectives, such as . . . the environment, do not constitute indirect expropriations." The majority of TEPAC believes the "rare circumstances" language should even be strengthened for greater clarification.

Also noteworthy are the concepts which motivate Paragraph 1 of Article 10.2 and Article 10.11 of the chapter on investment, particularly when combined with the other language in the Agreement cited above. Paragraph 1 of Article 10.2 states that in the event of an inconsistency between the Investment Chapter 10 and another chapter (like the chapter on the environment), the other chapter (Chapter 18) trumps Chapter 10. As the majority of TEPAC reads these provisions, any bona fide environmental requirement at odds with an investment-related requirement will trump that latter requirement. Similarly, Article 10.11 expressly precludes reading Chapter 10 to prevent environmental protections taken pursuant to the chapter on the environment. Additionally, Article 10.3 of Chapter 10 applies National Treatment; Article 10.4 requires Most Favored Nation treatment; and Article 10.5 requires a minimum standard of treatment that invokes due process in terms that seem expansive, and thus inclusive, of U.S. notions of due process.

However, TEPAC remains concerned about identifying protected interests with the phrase "a tangible or intangible" property right or interest. There is a lack of clarity regarding the definition of this term and there is no comparable U.S. jurisprudential concept. This raises the possibility that the resolution of disputes under the Agreement could be inconsistent with U.S. law. To further enlighten the appropriate development of this now more refined concept, we urge the respective national governments to exchange soon, and in an appropriately formal manner, exemplars of what currently constitutes such an "indirect expropriation" in each of their respective legal regimes in order to better inform each national perspective as to the current

application of this critical concept in the other's jurisdiction. These exemplars should also be made available to any empanelled arbitral panel for appropriate reference.

c. Public participation and implementation of the chapter

As it has stated in all of its previous reports, TEPAC believes that public participation is an integral aspect of the implementation and ongoing operation of the environmental provisions of FTAs. As with the other recent FTAs, the Peru Agreement includes a significant public participation provision. For example, this majority welcomes the mandatory requirement for the formation of a national environmental advisory committee in Section 18.6(5). A majority of TEPAC is pleased to see that steps are being made to increase public participation in the region and urges USTR and Congress to monitor closely the implementation of these provisions.

However, this majority notes that the TPA falls short of providing the extensive public participation framework which appeared in the Central American Free Trade Agreement (CAFTA). TEPAC believes that the inclusion of such a framework would significantly increase the likelihood that the Agreement's environmental provisions will be fully and effectively implemented. TEPAC notes that Section 18.6 of the Agreement specifically notes that "[t]he Parties shall further develop provisions to provide for the receipt and consideration of public submissions" and urges that the United States and Peru modify the agreement as soon as possible to include a CAFTA-like framework. This is particularly important given that this agreement will most likely serve as a template for the remainder of the Andean Free Trade signatories.

d. Dispute resolution

A similar majority of the members believes the dispute resolution procedures will help ensure that the TPA meets Congress's environmental objectives. If fully implemented, the Agreement maintains the positive steps taken in prior Agreements regarding transparency and, to some degree, in the participation of civil society during the settlement of disputes in trade cases. However, the majority is concerned that the public submission process does not reflect a mandatory requirement for acceptance of such statements. It believes that public participation in the dispute settlement process will enhance the likelihood that Congress' objectives will be met.

As with the other recent FTAs, the provisions regarding transparency and participation of civil society during the settlement of disputes in trade cases are significant improvements over historic practices. Also significant is the inclusion of Article 21.8(1)(a), requiring that members of panels examining environmental disputes have "expertise or experience relevant to the subject matter that is under dispute."

With regard to public submissions, however, a majority of TEPAC members believe that the dispute settlement provisions should make clear that submissions from persons and interested parties (both private sector and NGOs) should be accepted and considered to the extent appropriate as determined by the panel. Such a provision was incorporated into the Central American and Australian FTAs and should be incorporated here.

Finally, the majority believes that the Agreement's monetary penalties of up to \$15 million per year for instances of non-compliance with rulings confirming violations of enforcement requirements is an adequate compromise position. It is also pleased to see the maximum penalty indexed for inflation, although it notes the version of the TPA it was provided to review has yet to set a specific date as to when that indexing begins. However, this majority stresses that it continues to examine the efficacy of this provision and notes that its past satisfaction therewith has been and remains based in large part on the finding of a proper balance between the size of the penalty on the one hand and the strength of environmental cooperation (and associated funding commitments) mandated by the Agreements and the need to ensure that parties commit the requisite resources to enforce domestic environmental laws and regulations on the other hand.

e. Capacity building

A majority of the Committee believes that the Memorandum of Understanding provides a reasonable basis for the fulfillment of Congress's objectives regarding capacity building and sustainable development. It establishes a reasonable framework for the development of environmental cooperation projects and sets forth a reasonable range of areas for cooperation. However, the Memorandum of Agreement would be improved by the inclusion of specific areas of cooperation. While areas of cooperation are included, they are at a general, conceptual level that affords very little guidance on which subjects will receive the parties' focus. For example, there is no attempt to address the mahogany trade despite evidence that some of it is being conducted in violation of CITES. The majority believes that this issue should be specifically addressed.

As with other agreements, the majority would strongly prefer that Congress provide a dedicated funding source to ensure that the potential inherent in the Memorandum of Agreement is realized. Without a funding source, achievement of the goals of the Memorandum of Agreement is at best ephemeral. This issue is becoming increasingly significant as more FTAs are executed. Each FTA has contained capacity building provisions, but no funds have been set aside. Soon, these agreements will be competing with each other for scarce funds. A majority believes there is too much competition for funds and too often environmental projects are not afforded appropriate priority. A majority of TEPAC believes that this and future FTAs should contain provisions for dedicated funding and technical assistance from governments and international financial institutions as well as funding commitments for public/private sector ventures. This is necessary to both ensure adequate funding of projects to be implemented in the short- and medium-term as well as projects to be developed over the long term. Also, the majority believes that an agreement with the significance of the Memorandum of Understanding should be an integral part of the FTA rather than a side agreement. This flaw is magnified by the fact that the side agreement is a draft not yet finalized or signed by the member countries. Should the Memorandum of Understanding change to any great degree, the majority's opinion regarding its provisions would need to be reexamined.

f. Market access

In order to determine whether the Agreement fulfills Congress's mandate to seek market access, through the elimination of tariffs and nontariff barriers, for United States environmental technologies, goods, and services, TEPAC requested that USTR identify the extent of the Agreement's tariff reductions for such items. USTR's analysis concluded that, for environmental products, 89 percent of U.S. exports will receive duty-free treatment immediately upon implementation of the agreement. Tariffs on another 7 percent of exports will be eliminated over five years, and 2 percent will be eliminated over seven years. Duties on the remaining 2 percent of U.S. exports will be eliminated over ten years. Tariffs on high-priority environmental goods such as pumps and filtration equipment will be eliminated immediately upon implementation of the agreement. Presuming the accuracy of these figures, the majority of TEPAC concludes that this tariff elimination schedule fulfills Congress's mandate on this issue.

g. Other concerns

i. Corporate stewardship

Some prior FTAs, including the Singapore FTA (Art 18.9) and the Chile FTA (Art 19.10) include a statement on promoting sound corporate stewardship. No such provision appears in the text of the Peru environment chapter. While there is text (in Art 18.4(1.b)) on incentives (such as market-based incentives and public recognition), a majority of the Committee is of the opinion that this language is not a sufficient replacement for a more active provision promoting good corporate behavior. This majority continues to believe a corporate stewardship provision should supplement the incentives provision in future FTAs.

ii. Biological diversity

A majority of TEPAC is pleased to see that an article on biological diversity has been included in the FTA's environment chapter (Art. 18.8). This majority supports the commitment the Parties have made to the maintenance of biological diversity, but is concerned about the use of the term "sustainable use" in Article 18.8(2). This phrase has recently been interpreted in some international conventions to allow for extensive harvesting and/or use of diverse species. TEPAC understands that this was not the intent of the parties in utilizing this phrase and that it was selected in order to conform with the term currently used in Andean law. TEPAC recommends an exchange of letters between the parties to clarify that their intent was not to allow for extensive harvesting and/or use of diverse species and that they intend this phrase to have the same meaning as the term "sustainability."

3. Other Points of View

As stated above, several committee members hold views which run contrary to the majority views presented above. They are summarized below and presented more fully in the memoranda attached hereto.

- i. The Agreement's intellectual property provisions are harmful to consumers.

A minority believes that, contrary to the Doha Declaration on the TRIPS Agreement and Public Health, and notwithstanding the Peru TPA's proposed statement of "understanding regarding certain public health measures" with respect to the WTO TRIPS agreement, the U.S.-Peru Trade Promotion Agreement's intellectual property provisions do not implement the TRIPS Agreement "in a manner supportive of public health and, in particular, to promote access to medicines for all." Indeed, this minority believes the Agreement reduces access. It believes that the Agreement will reduce access to affordable generic medicines for Peruvian consumers.

- ii. The Agreement's investment provisions weaken traditional protections for U.S. investors.

A minority disagrees with the majority view that the investment provisions of the Agreement are an "improvement" over NAFTA. On the contrary, this minority believes the Agreement weakens the protections traditionally afforded U.S. investors under NAFTA and BITS. The Agreement again uses the "minimum standard of treatment of aliens" language first adopted in 2001 as a NAFTA clarification and subsequently incorporated into the agreements with Chile and Singapore. This minority believes this is too narrow a standard, which is not in keeping with the congressional mandate to negotiate fair and equitable treatment consistent with U.S. legal practice and law. The Agreement also inappropriately narrows the protection to "a tangible or intangible property right or interest" rather than to an investment. This could have adverse implications for U.S. investors abroad, which are more likely to face a more restrictive definition of "property" than foreign investors enjoy in the U.S. Finally, this minority also notes that the phrase "in rare circumstances" in the Annex creates a potential loophole because it gives Parties too much discretion in deciding what constitutes an indirect expropriation without providing any recourse to the foreign investor.

- iii. A minority disputes the need for greater regulatory oversight of environmental issues as a result of increased trade.

A minority disputes the need for greater regulatory oversight of environmental issues as a result of increased trade. More open trade can lead to economic growth, providing greater resources to address environmental concerns. Trade agreements should focus on this positive impact, not seek to use trade policy as a tool to force changes that might--or might not-- advance environmental goals.

- iv. More extensive environmental provisions that were included in other FTAs, such as those in CAFTA-DR, should not have been used as a template and included in the Peru Agreement

More extensive environmental provisions that were included in other FTAs, such as those in CAFTA-DR, should not have been used as a template and included in the Peru Agreement, as each trade agreement must recognize the uniqueness of each country, including the application of environmental provisions. In relation to public participation, a minority of TEPAC points to the

extensive provisions included in the Agreement and disagrees that including the CAFTA-DR framework for public participation would be a positive step. Rather, such a focus on procedural and bureaucratic minutiae can deflect needed resources from addressing important issues.

- v. A "sound corporate stewardship" statement is not needed in the Agreement

A minority does not support inclusion of a "sound corporate stewardship" statement in the Agreement, as that term is vague, subject to various interpretations, and thus is inappropriate for inclusion in a trade agreement.

- vi. The Memorandum of Understanding (MOU) on environmental capacity building need not to be an integral part of the FTA

A minority does not see the need for the Memorandum of Understanding (MOU) on environmental capacity building to be an integral part of the FTA. Environmental capacity building is a complicated process that requires flexibility and adjustments better dealt with in a separate agreement. Neither does this minority agree with the recommendation that dedicated sources of funding for capacity building be identified in the MOU. Peru's needs and priorities may change, and such dedicated funding sources may not allow for needed flexibility for the country to meet those changing needs.

- vii. The biological diversity provision fails to recognize that property rights and technological advances can lead to higher yields and greater resource efficiency.

The biological diversity provision, while promoting the importance of conservation and sustainable use in pursuing that goal, fails to recognize that property rights and technological advances that can lead to higher yields and greater resource efficiency are critical components in building a more sustainable future for Peru.

- viii. The Agreement's investment provisions contain troublesome substantive rules and investor-state dispute settlement procedures and fail to provide an appellate procedure to curb errant arbitral panels.

A minority believes that it is not clear that the investment provisions comply with the direction from Congress that new international investment rules not provide foreign investors with "greater substantive rights" than domestic investors enjoy under U.S. law. Nor does the approach address the fundamental problems with the NAFTA/BIT approach. In addition, the failure to include an appellate review process ensures that investor-initiated disputes will continue to threaten to stretch traditional international law concepts in ways that undermine national regulatory powers and frustrate efforts, particularly in developing countries, to achieve sustainable development.

The inclusion of terms like “fair and equitable” provide arbitral panels with standards that do not exist in U.S. law. The lack of an appellate process and the lack of any oversight role for U.S. courts inhibit the development of a clear jurisprudence consistent with U.S. investor protections. Some have raised the question of whether or not the investor-state dispute mechanism is consistent with the U.S. Constitution given that it can decide cases otherwise subject to the Constitution’s provisions on the judiciary. The failure to fully understand the impact of the proposed rules on domestic regulation (either domestically or abroad) undermines assertions that these agreements will support sustainable development. Finally, there is the continued imbalanced approach to the treatment of investors (most of which are corporate actors) as opposed to citizens generally in U.S. foreign economic policy. Investors are given explicit rights and enforcement mechanisms to hold governments accountable. But the investment rules do not even mention, much less require, minimum standards of corporate conduct on investors acting abroad.

Attachment 1

Separate Statement of TEPAC Members Rhoda H. Karpatkin, President Emeritus, Consumers Union of United States, Inc.; William A. Butler, Audubon Naturalist Society; Daniel B. Magraw, Center for International Environmental Law; and Durwood Zaelke, Institute for Governance and Sustainable Development

February 1, 2006

We agree with some portions of the TEPAC Report and disagree with others. We also have additional views on an issue that is not touched upon by the majority in the Report, but which we believe Congress should consider. We are thus submitting these additional comments, based on a review of the U.S.-Peru Trade Promotion Agreement text.

Intellectual Property Protections for Pharmaceuticals Section 2102(4)(b)(C) of the Trade Act of 2002 establishes the objective that trade agreements respect the Declaration on the TRIPS Agreement and Public Health, adopted by the World Trade Organization at the Fourth Ministerial Conference at Doha, Qatar, on November 14, 2001.

The Doha Declaration on the TRIPS Agreement and Public Health, specified in this objective, recognizes the tension between the contribution of intellectual property to the development of new medicines and “the concerns about its effects on prices.” It calls on WTO members to implement the TRIPS “in a manner supportive of public health and, in particular, to promote access to medicines for all.”

As we have noted in separate statements in TEPAC reports on several other bilateral free trade agreements, most recently the agreement with Oman, the relevant provisions of the Peru Free Trade Promotion Agreement instead creates roadblocks to such access.

Access to medicines – affordability – in practical terms, equates to the availability of generics and to compulsory licensing in some cases. The Peru Agreement contains provisions that delay and increase the difficulty of bringing generic drugs to market and, hence, reduce access to affordable medicines for Peruvian consumers.

The intellectual property provisions of this agreement, and those in other recently negotiated agreements, will create upward pressure on the prices of medicines globally. Millions of people suffering from life-threatening diseases will be denied access to affordable, essential medicines as a result.

This is of particular concern for the increasing number of people suffering from HIV/AIDS. It is of great concern at this moment, as well, because the world faces an avian flu pandemic. Fighting a contagious disease in one country can help prevent or mitigate its spread to other countries.

We do note that the Peru TPA would include a separate “Understanding Regarding Certain Public Health Measures” that might address some of our concerns regarding medicines for AIDS, avian flu, malaria and other epidemics. However, this separate understanding does not

assure affordable medicines in the event of an actual epidemic. Moreover, the Declaration and the Understanding do not apply to the vast majority of medicines that consumers need for many widespread illnesses and medical conditions.

These recently negotiated free trade agreements – including the Peru Agreement – would impede generic competition by creating intricate market authorization and medicine registration procedures, and by limiting the grounds on which compulsory licenses can be issued. Under its intellectual property provisions, special five year monopoly protections are created for pharmaceutical test data required to demonstrate safety and efficacy, and to authorize a drug's use (see Article 15.9.1). These provisions would greatly delay and limit generic competition, even if no patent barriers exist. In addition, pharmaceutical patents would be extended beyond the 20 years required by the WTO (see Articles 15.8.6), further slowing the introduction of affordable generic drugs.

Similar provisions are included in free trade agreements negotiated with Australia, Bahrain, the Central American states, Chile, Morocco, Singapore and Oman. It is clear by now that a pattern has been established that will impose these or similar provisions in most if not all future free trade agreements. Public health on a global scale will suffer as a result, as these provisions create upward pressures on prices and reduce access to affordable drugs. The United States made an international commitment in Doha. We should not systematically chip away at that commitment through regional and bilateral agreements with countries that are realistically left with no choice other than to agree to such provisions in order to reach what they perceive as valuable trade agreements with the United States. The United States government should honor the commitment it made in Doha and, through that Declaration, should commit to protecting the lives of millions of seriously ill people in countries around the world who desperately need access to affordable, life-saving and life-bettering medicines.

In addition, these provisions in the Peru Agreement do not benefit American consumers. While it has been suggested that such provisions will lower the price of medicines in the United States, this is unrealistic. There is simply no mechanism to translate higher prices for Peruvians and the developing countries with whom we have FTAs into lower prices for U.S. consumers.

The Congress has been grappling with the issue of affordability of medicines for American consumers. A succession of bilateral trade agreements, expanding patent rights and introducing new limitations on the ways generics can be marketed, may well have a preemptive effect, intruding on the prerogatives of the Congress to define national and global policy. Questions have already been raised about the interference of such provisions with the authority of Congress to enact drug re-importation legislation.

The Congress should also note that provisions such as these exacerbate the view, widely held among so many of the world's consumers, that America is advancing the profits of its drug companies at the expense of global public health. This view has been a stumbling block in recent trade negotiations. The Doha Development Round is already a difficult challenge.

We urge the Congress to take these considerations into account.

Attachment 2

February 1, 2006

Comments of the Competitive Enterprise Institute and the Hudson Institute's Center for Global Food Issues on the Trade Promotion Agreement with Peru

Submitted by Frances B. Smith, Competitive Enterprise Institute, and Dennis T. Avery, Hudson Institute's Center for Global Food Issues

General comments

In responding to the mandate for the Trade and Environmental Policy Advisory Committee (TEPAC), the Competitive Enterprise Institute (CEI) and the Hudson Institute's Center for Global Food Issues (CGFI) believe that the U.S.-Peru Trade Promotion Agreement carries out the objectives, including the environmental objectives, mandated by Congress in the Trade Act of 2002.

The Agreement is very unlikely to have adverse effects on the U.S. or on Peru, either economically or environmentally. The U.S. is already the most important trading partner of Peru in terms of exports, imports, foreign investment, and tourism. As a result of the Andean Trade Preference Act and the Andean Trade Promotion and Drug Eradication Act, the majority of Peru's exports to the U.S. are duty-free. This Agreement furthers those goals and provides greater certainty in their continuation.

Our reservations on the Agreement and our dissent from the TEPAC majority report stem from the Agreement's excessive reliance on environmental mandates as a direct means to advance various environmental objectives. As noted, trade can create wealth, and, in that sense, the most effective means of advancing environmental objectives around the world is to move toward free trade. Trade agreements should focus on this positive impact, not seek to use trade policy as a tool to force changes that might – or might not – actually advance some environmental objective. Environmental goals should be pursued directly – not via restrictions to trade expansion.

In relation to the U.S.-Peru Trade Promotion Agreement and environmental goals, CEI and CGFI would emphasize the importance of recognizing that higher environmental standards are best achieved through better economic and institutional conditions, and that trade and open economic systems can lead to improved economic performance, help to reduce poverty, and increase living standards for all participants. As people achieve greater wealth and more economic independence, more resources can be freed up to protect the environment. Besides the exchange of products and services, economic and social ideas can also flourish through increased trade.

To facilitate these critical goals, trade agreements should focus on their main purpose and not be overloaded with a range of issues that cannot (and should not) be solved by trade negotiators. Many of those issues might have an economic background, such as investment rules and intellectual property rights, while others might relate to other concerns.

Those issues should be discussed and negotiated in their appropriate venues, and international and bilateral agreements relating to those issues are better forged through expert negotiations focusing on those issues.

CEI and CGFI dissent from the majority report's recommendations for expansion of environmental provisions similar to those in the U.S.-Central America-Dominican Republic Free Trade Agreement (CAFTA-DR). It is critical that we focus efforts not on detailed bureaucratic and procedural approaches to environmental concerns but on building the underlying institutional framework that can make a real difference.

Legal ownership rights and legal barriers to establishing businesses should be a focus of environmental cooperation and capacity-building to reach environmental goals. Institutions--especially property rights and the rule of law--are key foundations for environmental improvements. In helping to build Peru's capacity to improve the environment, strengthening these fundamentals should be encouraged.

Thus, CEI and CGFI do not concur with the majority report's statement that increased trade requires greater regulatory oversight of environmental issues.

Environmental objectives

CEI and CGFI agree with the majority report that the U.S.- Peru Trade Promotion Agreement meets the environmental objectives set forth in the Trade Act of 2002.

CEI and CGFI also share the view of the majority that FTAs are to be tailored to individual countries and should not follow a "one size fits all" approach. However, the majority report seems to contradict that approach by advocating the inclusion of specific environmental provisions that appear in CAFTA-DR.

It is both logical and appropriate that the Peru FTA – and other trade agreements -- do not use a prior trade agreement as a rigid template. Each country is unique, with a unique relationship with the U.S., as well as unique national concerns, including those relating to environmental issues.

In contrast to the majority view and its endorsement of the need for more regulatory oversight, CEI and CGFI would point to the role of institutions--especially property rights and the rule of law—that are key foundations for environmental improvements. In helping to build countries' capacity to improve the environment, strengthening these fundamentals should be encouraged. Environmental goals should not be pursued via restrictions to trade expansion.

As Peruvian development economist Hernando De Soto has pointed out and demonstrated over the past decade, the rule of law and clearly defined private property rights offer the greatest hope for improving the lot of the world's poor by empowering them to use the capital already available to them to generate wealth and prosperity. These institutions also are essential for sustainable environmental improvements. Once a resource becomes a legally recognized asset, people will tap into its value to both protect and enhance that resource, whether a farm or a forest.

Numerous other studies have made similar findings. In a direct relationship to the environment, Madhusudan Bhattarai (2000) found that civil and political liberties, the rule of law, the quality and corruption levels of government, and the security of property rights were important in explaining deforestation rates in sixty-six countries across Latin America, Asia, and Africa.

Investment Provisions

In dissenting from the TEPAC majority report on the investment provisions in the U.S. – Peru Trade Promotion Agreement, CEI and CGFI would like to address a broader issue. We would point out that concerns about investments are better dealt with in a separate investment agreement--if countries wish to do so--but should not necessarily be part of a bilateral trade agreement. Currently, according to information on the U.S. Department of State's website, Peru does not have a bilateral investment treaty with the U.S. However, the country has committed to arbitration of investment disputes under the auspices of certain international or national arbitration tribunals.

Investment rules and challenges to domestic regulations should be considered, as far as possible, in the domestic legal systems of those countries. Countries that fail to adequately address the concerns of investors will likely face economic consequences in lower levels of foreign investments. While closer cooperation and facilitation between the Parties might help to bridge different concepts of investment and its protection, enforcement outside of the domestic legal system can pose significant problems and concerns relating to public acceptance, the rule of law, and national sovereignty.

The provisions in the U.S.-Peru Trade Promotion Agreement regarding the definition of investment and what would constitute an "expropriation" might or might not be an improvement from the approach in the North American Free Trade Agreement (NAFTA); however, the effort to clarify the meaning is a positive one. Nevertheless, a better understanding of the effects on domestic regulatory regimes would also help to achieve better public acceptance of such agreements.

Public participation

As does the majority of TEPAC, CEI and CGFI strongly support public participation as an integral part of the democratic political process. It is encouraging that Peru has committed to provisions that call for greater civic involvement and transparency in relation to environmental issues.

Our dissent concerns the majority report's view that a CAFTA-like framework for public participation should be included. CEI and CGFI would note that the agreement in Article 18.5 establishes an Environmental Affairs Council that would establish mechanisms and procedures for public participation relating to exchanging information, providing input for meetings, and receiving public views and comments on the issues. In addition, Article 18.6 outlines numerous

opportunities for public participation in providing input, submissions and consultations in relation to implementation of the environmental provisions.

With such extensive public participation provisions in the Agreement, CEI and CGFI are opposed to further expanding those using the CAFTA model, which creates a complex bureaucratic structure that may deflect the focus toward procedural and bureaucratic minutiae rather than substantive issues.

Sound corporate stewardship

CEI and CGFI do not support inclusion of a “sound corporate stewardship” statement in the agreement, as the term is vague, subject to various interpretations, and thus is not appropriate for inclusion in trade agreements.

Biological diversity

Article 18.8 promotes the importance of conservation and the sustainable use of biological diversity and their role in achieving sustainable development. While the majority report views the inclusion of that article with approval, CEI and CGFI would point out that the article fails to recognize that property rights and technological advances to produce higher yields and greater resource efficiency in agriculture are critical components in building a more sustainable future in Peru. Subsistence agriculture in Peru and other countries is the greatest threat to fragile ecosystems. A World Bank report points to some of the problems in rural areas of Peru that put pressure on the environment:

“The situation in Peru’s *sierra* is similar to other marginal regions in Latin America: the highlands of other Andean countries and mountainous rural districts in Mexico and Central America. For historical reasons, these areas have high populations relative to available agro-ecological resources. The environment is fragile. Limited resources, bad communications and physical access, poorly educated labor forces and *land access impaired by restrictions on property rights all inhibit development of modern market conditions and technically advanced production methods*, and deter private venture capital. Population growth puts further pressure on resources. The lack of opportunities in the wider economy relegates most people to low productivity employment in a semi-subsistence economy where their main asset (land) is undergoing serious environmental degradation. They scratch precarious livings on small plots in often-harsh environments.” [italics added] (Pierre Werbrouck, “Designing a rural development strategy for Peru’s *sierra*,” World Bank, October 2004).

In closing, CEI and CGFI are concerned the Agreement and the majority report fail to consider the critical elements that contribute to sustainability – expanded economic opportunities, property rights, and access to technology.

Attachment 3



CENTER FOR INTERNATIONAL ENVIRONMENTAL LAW (CIEL)

Separate Comments of TEPAC Members on the U.S.-Peru Trade Promotion Agreement

Daniel Magraw, President, Center for International Environmental Law

William Butler, Board Member, Audubon Naturalist Society

Rhoda H. Karpatkin, President Emeritus, Consumers Union of U.S., Inc.

February 1, 2006

The Peru Free Trade Agreement (FTA) is critically inadequate with respect to its investment provisions, which contain troublesome substantive rules and investor-state dispute settlement procedures and fail to provide an appellate procedure to curb errant arbitral panels.

I. General Comments on the Investment Chapter

The approach to international investment rules embodied in the Peru FTA contains some incremental improvements over the North American Free Trade Agreement (NAFTA) and model Bilateral Investment Treaty (BIT) approaches. It is not clear, however, that the provisions we have reviewed comply with the direction from Congress that new international investment rules not provide foreign investors with “greater substantive rights” than domestic investors enjoy under U.S. law¹. Nor does the approach address the fundamental problems environmental groups and others have identified with the NAFTA/BIT approach. In addition, the failure to include an appellate review process ensures that investor-initiated disputes will continue to threaten to stretch traditional international law concepts in ways that undermine national regulatory powers and frustrate efforts, particularly in developing countries, to achieve sustainable development.

Experience with cases being brought under existing agreements (chiefly NAFTA and numerous BITs) demonstrates that individual investors are pushing for expansive readings of the substantive obligations in those agreements. Further tilting international investment rules in favor of investors at the expense of the ability of governments to regulate in the public interest is a threat to good governance and public welfare. The reliance on domestic courts in the first instance, and on state-to-state dispute settlement only if needed, provides more appropriate fora for protecting the rights of investors. In addition, requiring investors to rely in the first instance on domestic legal remedies helps build the rule of law by allowing national legal regimes to resolve any legitimate claims by investors. Allowing investors to remove disputes from national legal systems, as is the case in the Peru FTA, stunts the development of those systems.

¹ Part III below addresses in more detail the failure of the agreements to meet the “no greater substantive rights” standard.

The explicit limitation of the minimum standard of treatment provision to “customary international law” corrects one serious flaw with the NAFTA approach, which referenced only “international law.” Of course, the content of customary international law with respect to the treatment of aliens is not crystal clear, and arbitral panels have applied this standard in idiosyncratic fashion, e.g. *Occidental v. Ecuador* and *CMS Gas v. Argentina*.

The agreement references international law concepts as the guideposts for interpreting the substantive obligations – leaving substantial interpretive room for arbitrators to exploit. The inclusion of terms like “fair and equitable” provide arbitral panels with standards that do not exist in U.S. law. The lack of an appellate process and the lack of any oversight role for U.S. courts inhibit the development of a clear jurisprudence consistent with U.S. investor protections. There can thus be no assurance that either expropriation or minimum standard of treatment provisions will be applied in a manner consistent with the U.S. legal norms as required by the Trade Act of 2002. Part III below details a number of specific ways in which the expropriation and minimum standard of treatment provisions fail to meet the “no greater substantive rights” standard.

Constitutional issues. Some have raised the question of whether or not the investor-state dispute mechanism is consistent with the U.S. Constitution given that it can decide cases otherwise subject to the Constitution’s provisions on the judiciary.² Given that the need for this mechanism is not clearly established, why should the U.S. enter into agreements that might embody an unconstitutional delegation of judicial power?

Regulatory effects not adequately understood. The bulk of the concerns expressed by environmental groups and others involve the regulatory effects of the investment rules. In other words, the rules and the investor-state process have been used to challenge domestic regulations designed to protect the environment and public health or advance other important social objectives. The failure to fully understand the impact of the proposed rules on domestic regulation (either domestically or abroad) undermines assertions that these agreements will support sustainable development.

Failure to correct imbalance. Finally, we see the continuation of an imbalanced approach to the treatment of investors (most of which are corporate actors) as opposed to citizens generally in U.S. foreign economic policy. Investors are given explicit rights and enforcement mechanisms to hold governments accountable. But the investment rules do not even mention, much less require, minimum standards of corporate conduct on investors acting abroad.

II. Specific Concerns with the Investment Chapter

Definitions. The definition of investment differs markedly from that in NAFTA and appears to be even broader in scope. The effect of this definition is not clear, but at a minimum it raises questions as to the types of property interests the agreement seeks to protect and whether those notions are consistent with the limited notion of protected property interests under the U.S. Constitution and case law. The reference in the expropriation annex to “a tangible or intangible property right or property interest” does little to elucidate the precise scope of property interests

² See, John Echeverria, “Who will Decide for Us?” *LEGAL TIMES*, March 8, 2004.

protected by the agreement for purposes of ensuring consistency with the “no greater substantive rights standard.”

Distinguishing investors based on environmental criteria. In the non-discrimination provisions (national treatment and most favored nation treatment) there is no clarity regarding the extent to which environmental criteria can be used as the basis to fairly distinguish between investors. In particular, there is no explanatory note that would ensure that future panels are guided by a notion of “like circumstances” that would accept environmental criteria as an important part of the like circumstances analysis. The classic example is in regulating point source pollution of a river. The absorptive capacity of the river system could, for example, allow five sources of pollution without significant harm, but a sixth could create too heavy a load and result in significant environmental harm. Would national treatment require the sixth facility (identical in everyway to the first five, but for foreign ownership) to be compensated if it is not allowed to operate? The negotiators have demonstrated at numerous points in the text a willingness to try to provide panels with guidance, and the failure to do so here is puzzling – particularly, as noted below, when there is no general environmental exception for the investment chapter.

Lack of environmental exception. The failure to include a general environmental exception to the investment chapter is a further indication that international investment rules remain a significant threat to environmental and other policies enacted by governments to further the public interest. If, as the supporters of strong investment protections argue, such rules pose no threat to legitimate environmental regulations or actions of government, then why not ensure that result by clearly carving out such regulations from the ambit of the rules? The approach in Article XX of the GATT, if applied to investment, would ensure that governments are not required to compensate investors for the consequences of entirely legitimate and reasonable environmental regulation. As noted above, the failure to explicitly include environmental factors in the like circumstances analysis heightens the need for an effective environmental exception.

In addition, the Peru text includes a carve-out from the expropriation provision for tax laws (Article 21.3). This includes a mechanism by which the home and host countries can agree to disallow a claim for expropriation based on a tax measure. In our view, environmental and public health regulations serve societal objectives every bit as important as tax structures. The willingness to create a mechanism for governments to preclude an expropriation challenge for tax laws but not environmental laws again raises a question of whether the agreements strike the proper balance among the economic and non-economic objectives of government.

Performance requirements. The performance requirements section includes a puzzling environmental exception for some but not all of its provisions. The exception singles out some paragraphs and not others and directs that they not be construed in a way to prevent a Party from adopting or maintaining legitimate environmental measures. Does this mean that the paragraphs not mentioned may be construed to prevent a Party from adopting or maintaining legitimate environmental measures? If not, then why not apply the exception more broadly?

Expanding Arbitral Jurisdiction: Investment Authorizations and Investment Agreements. The Investment Chapter subjects investment authorizations and investment agreements to the compulsory jurisdiction of arbitral tribunals. The magnitude and implications of these

jurisdictional grants have not been adequately assessed, but it is immediately evident that they will have significant negative effects. This language undermines domestic legal systems by removing an important class of disputes from them, opens whole new areas of potential investor challenges to domestic regulatory programs, and provides foreign investors better treatment than U.S. domestic businesses have.

The investment agreements covered by them are not commercial disputes, but involve important policy questions regarding public assets, including natural resources such as oil, gas, and timber; public services, including water treatment and distribution and power generation and distribution; and infrastructure projects, such as roads, bridges, canals, dams and pipelines.

In particular, we are concerned about the role of the U.S. judiciary and the administration in upholding the rule of law. Whether a party is in breach of investment agreements or authorizations should be determined under applicable U.S. law, and through the statutorily mandated process of administrative courts followed by appeal, if necessary, to U.S. federal courts. That comprehensive body of law defines the competence, rights and obligations of the U.S. government regarding its contracts, including those concerning natural resources, public services, and infrastructure projects. Similarly, that procedural system ensures fairness and consistency in dealing with the multitude of issues involved in U.S. government contracting. It is also critically important that legitimate U.S. regulatory decisions (e.g., regarding health, environmental, communications, energy, and nuclear issues) be tested in the U.S. court system and be subject to U.S. laws, not subject to second-guessing by ad hoc arbitrators.

If it is problematic for foreign investors to take disputes over U.S. contracts and administrative and regulatory measures out of the established domestic processes designed to review them, then it is equally problematic for U.S. investors abroad to bypass the national judicial system of the host country to challenge that country's administrative and regulatory systems, absent a showing of futility. Respect for the rule of law requires that domestic legal processes be given the opportunity and responsibility to work.

The inclusion of a separate jurisdictional grant in the Investment Chapter is also unnecessary, because rights conferred by these investment authorizations and agreements are already protected, to the extent that they are included in the definition of investment by substantive expropriation disciplines. What the new jurisdictional grants do is to make any dispute and all issues arising out of these agreements actionable for damages before unaccountable, ad-hoc arbitral tribunals.

This expansion of the investor-state arbitration is problematic, no less because these disputes can involve the collection of royalties over natural resource extraction, as well as out of measures adopted by U.S. agencies to exact compliance with their regulations governing public services.

III. The Investment Provisions of the Peru FTA Fail to Meet the “No Greater Substantive Rights” requirement of the Trade Act of 2002

The Trade Act of 2002 requires that investment provisions “ensur[e] that foreign investors are not accorded greater substantive rights with respect to investment protections than United States investors in the United States....” Section 2102(b)(3).

Like the Chile and Singapore FTAs, the Peru FTA clearly reflects a departure from the investment provisions in previous agreements to which the U.S. is a party, including NAFTA Chapter 11; however, those changes fail to meet the standard articulated by Congress. While there are potentially helpful elements in the proposals, they fail to adequately reflect U.S. law, or even international law, in many respects – including the particular Supreme Court decision, *Penn Central*, on which USTR intended to base much of the standard for expropriation.

The Peru FTA cannot ultimately comport with the “no greater rights” congressional mandate if foreign investors are able to bring claims that would be decided by ad hoc panels that are not trained in or bound by U.S. Supreme Court precedent and that would not be subject to review by U.S. courts to ensure that they do not in fact deviate from U.S. law and grant greater rights to foreign investors. The prospects of such panels engaging in subjective balancing tests, and on the basis of those, imposing financial liability on the U.S. for legitimate regulatory and other actions is extremely troubling.

The agreements are also flawed, however, in failing to do what they purport to do – that is, reflect U.S. law. A number of particular concerns regarding the standards for expropriation and minimum treatment are addressed below.

Expropriation

In attempting to define a standard for expropriation, the agreement (Annex 10-B) first references customary international law on expropriation and then focuses on a limited, and imbalanced, set of the critical factors used by the Supreme Court in determining takings cases. The agreement fails to include critical standards established in U.S. jurisprudence that preclude findings of compensable expropriations, and leaves unclear in a problematic manner some of those that it has chosen to reference. For example, they do not include the critical Supreme Court principle that a governmental action must permanently interfere with a property in its entirety in order to meet a threshold requirement to constitute a taking.³ Simply listing some of the factors the Supreme Court discussed in *Penn Central*, but without the essential explanations and limitations that were set forth in that case and in subsequent rulings, provides no assurance that foreign investors will not in fact be granted greater rights than U.S. investors. This failure to provide explanations and limitations for critical standards includes the use of the “character of

³ The Supreme Court has clearly stated that takings analysis must be based on the effect of the government action on the parcel as a whole, not its segments. *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 130-31 (1978). This standard prevents segmenting a property, whether measured in terms of area or time, as clearly articulated in the Supreme Court’s *Tahoe-Sierra* case, which rejected a taking claim arising out of a temporary moratorium on development. *Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency*, 122 S. Ct. 1465 (2002)

government action” as a factor in expropriation analysis. “Character of government action” is extraordinarily ambiguous and could easily be misapplied by tribunals that are neither trained in nor bound by U.S. precedent.⁴ In addition, the language concerning the analysis of an investor’s expectations is too vague, leaves too much to the discretion of the arbitrators, and does not indicate the deference to governmental regulatory authority that is found in U.S. jurisprudence.⁵ Property rights are not defined in the agreement, nor is there any reference to the fact that under Supreme Court cases takings claims must be based upon compensable property interests, which are defined by background principles of property and nuisance law. *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1029 (1992). Furthermore, the agreement fails to include the fundamental distinction between land and “personal property.”⁶

While the “rare circumstances” language in the agreements provides some direction for arbitral panels, it fails to adequately convey the degree to which it is unlikely that a regulatory action would be considered an expropriation under U.S. law. It would take an extreme circumstance for any of the thousands of our country’s laws and regulations to be found to constitute an expropriation. It would be more accurate to state that regulatory actions designed to protect health, environment, or the public welfare do not constitute an expropriation, except in instances equivalent to a permanent, compelled, physical occupation.⁷

Minimum Standard of Treatment

In regard to minimum, or general, treatment, we are deeply concerned that the term “fair and equitable treatment” has been included as an essential element of the standard. “Fair and equitable treatment” opens the door to outcomes in investment cases that go far beyond U.S. law. While we welcome the clarification that “fair and equitable” includes procedural due process,

⁴ The Supreme Court’s reference to that factor in *Penn Central* as reflects a clear limitation on takings claims under U.S. law that is not evident in an unexplained reference to the “character of government action.” See also *Lingle v. Chevron* (USSC May 23, 2005). In *Penn Central*, the Court explained that a “‘taking’ may more readily be found when the interference with property can be characterized as a physical invasion by government, . . . than when interference arises from some public program adjusting the benefits and burdens of economic life to promote the public good.” The Supreme Court thus referred to the character of government action to distinguish between a permanent invasion of land, which is more likely to give rise to a right to compensation, and normal regulatory action, for which compensation is only required in extreme circumstances that are equivalent to a permanent, compelled, physical occupation. Without a clear explanation of how the character of government action affects the analysis of a takings claim, a tribunal applying this factor would be free to interpret it so as to afford foreign investors far greater rights than the U.S. Constitution provides.

⁵ The expropriation annex does not include critical limitations stating that an investor’s expectations are a necessary, but not sufficient, condition for liability, that an investor’s expectations must be evaluated as of the time of the investment or that an investor must expect that health, safety, and environmental regulations often change and become more strict over time. For example, it fails to include the *Concrete Pipe* Court’s reiteration of the principle that those who do business in an already regulated field “cannot object if the legislative scheme is buttressed by subsequent amendments to achieve the legislative end.” *Concrete Pipe & Products v. Construction Laborers Pension Trust*, 508 U.S. 602, 645 (1993).

⁶ “In the case of personal property, by reason of the State’s traditionally high degree of control over commercial dealings, [the owner] ought to be aware of the possibility that new regulations might even render his property economically worthless (at least if the property’s only economically productive use is sale or manufacture for sale).” *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1028 (1992).

⁷ As the Supreme Court unanimously stated in the *Riverside Bayview* case, land-use regulations may constitute a taking in “extreme circumstances.” *United States v. Riverside Bayview Homes, Inc.*, 474 U.S. 121, 126 (1985).

inclusion of one principle in a standard does not eliminate the significant potential of a broader, unbounded interpretation of the standard. The terms “fair” and “equitable”, after all, are inherently subjective and incapable of precise definition.

- There is no right corresponding to “fair and equitable treatment” under U.S. law. The closest thing in U.S. law is the Administrative Procedure Act (APA), which allows a court to review federal regulations to determine whether they are “arbitrary or capricious.” First and foremost, the APA does not apply to many governmental actions (e.g., legislation, court decisions, actions by state, local and tribal governments, and exercises of prosecutorial discretion) that are covered under investment agreements. The two proposed agreements thus constitute a massive enlargement of foreign investors’ rights. Secondly, the APA does not provide for monetary damages (as these investment provisions would allow); only injunctive relief is allowed.

Foreign investors have the same rights as U.S. investors under the APA to seek injunctive relief. Enshrining this equal access in a trade agreement is one thing, but granting foreign investors the right to be paid the costs of complying with a requirement that may violate the APA but does not constitute a compensable taking under the Constitution as interpreted by the Supreme Court would clearly violate the Congress’ “no greater substantive rights” mandate. In other words, giving foreign investors the right to monetary damages under investment rules, where an identically situated U.S. investor would be limited to injunctive relief, would violate the “no greater substantive rights” mandate. Finally, U.S. courts are bound by deference doctrines in applying the APA; there is no equivalent doctrine in the Chile and Singapore agreements or other international law, to our knowledge.

- In addition, the “fair and equitable” language, if viewed as an independent standard, is extremely dangerous to good governance. It would invite an arbitral tribunal to apply its own view of what is “fair” or “equitable” unbounded by any limits in U.S. law. Those terms have no definable meaning, and they are inherently subjective. Indeed, we wonder how they can have any principled meaning when applied to countries with such different histories, cultures, and value systems as are involved in free trade agreements. The kind of second-guessing of governmental action—e.g., legislation, prosecutorial discretion, police action, court decisions, regulatory actions, zoning decisions, etc., at all levels of government—invited by this type of standard is antithetical to democracy.

Dispute Settlement

We also object to the references to the UNCITRAL rules in Article 10.15. These rules are inconsistent with transparency and public participation, both of which are essential because of, inter alia, the fundamental issues of public policy that are the subject of investment and state disputes. There is no reason to include any other dispute settlement possibilities than the International Centre for Settlement of Investment Disputes (ICSID) and the ICSID Additional Facility.